

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Bates Analyst: Kimberly Pantoja Bill Number: AB 763
Related Bills: See Legislative History Telephone: 845-4786 Amended Date: 04/05/1999
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Adoption Costs Credit Conformity

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL), this bill would repeal the existing state adoption credit and, by conforming with modifications to the federal adoption credit, allow a state credit equal to 50% of the costs above \$5,000 (\$6,000 in the case of a special needs adoption) but not in excess of \$10,000 paid or incurred by the taxpayer for an adoption that qualifies for the federal credit.

SUMMARY OF AMENDMENT

The April 5, 1999, amendments deleted the provision allowing a child adoption deduction and inserted the language discussed in this analysis.

The department did not complete an analysis of the bill as introduced.

LEGISLATIVE HISTORY

AB 119 (1997/1998) same language contained in this bill, died in Senate Appropriations; SB 1920 (Stats. 1994, Ch. 827) enacted the current Child Adoption Credit.

EFFECTIVE DATE

This bill is a tax levy and would apply to taxable years beginning on or after January 1, 1999.

SPECIFIC FINDINGS

Federal law provides that taxpayers may claim a nonrefundable credit for expenses incurred in adopting a child, up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). In addition, taxpayers may exclude from gross income employer contributions toward adoption expenses, up to a maximum of \$5,000 per adoption (\$6,000 for a special needs adoption). The credit and exclusion are phased out for taxpayers with adjusted gross income (AGI) between \$75,000 and \$115,000. The \$5,000 credit and the exclusions will not be available for expenses incurred after December 31, 2001. However, the \$6,000 special needs adoption credit is permanent. Any credit unused in the year earned may be carried forward for five years.

Current state law provides a credit equal to 50% (not to exceed \$2,500) of the costs paid or incurred by the taxpayer to adopt a minor child who is a citizen or

Board Position:

| | | |
|------------------|-----------|---------------|
| _____ S | _____ NA | _____ NP |
| _____ SA | _____ O | _____ NAR |
| <u>X</u> _____ N | _____ OUA | _____ PENDING |

Department Director

Date

Gerald Goldberg

5/10/1999

legal resident of the United States and was in custody of a public agency of California or political subdivision of California. The costs eligible for credit include fees for required services of either the Department of Social Services or a licensed adoption agency, travel, and expenses for the adoptive family that are directly related to the adoption process. In addition, medical fees that are not reimbursed by insurance and are directly related to the adoption are qualified expenses.

This credit may be claimed for the taxable year in which the decree or order of adoption is entered.

Any deduction for expenses on which the adoption credit is based is reduced by the amount of the credit allowed.

This bill would:

- repeal the existing state adoption credit; and
- by conforming with modifications to the federal adoption credit, allow a state credit equal to 50% of the costs above \$5,000 (\$6,000 in the case of a special needs adoption) but not in excess of \$10,000 paid or incurred by the taxpayer for adoptions that qualify for the federal credit.

"Eligible child" is defined as an individual who has not attained 18 years of age, or is physically or mentally incapable of caring for himself or herself, and the federal provision allowing only the credit for special needs adoptions after December 31, 2001, does not apply.

Policy Considerations

By generally conforming state law to federal law in the determination of which expenses would qualify for an adoption credit, this bill would simplify the preparation of the state tax return for affected taxpayers. However, since this bill's provisions allow a credit for costs which are ineligible for the federal credit (those exceeding \$5,000) and for non-special needs adoptions after December 31, 2001, when the federal provision for non-special needs adoptions expires, this bill would create a federal/state difference and may create confusion as to which taxpayers qualify for the credit.

This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

This bill repeals the current adoption credit and replaces it with a credit based upon the federal credit. As a result, the credit would be available to foreign and private adoptions which are excluded under current law, but would exclude most public agency adoptions since these adoptions generally cost less than the \$5,000 threshold for eligible costs in this bill.

Implementation Considerations

Implementation of this bill would not significantly impact the department.

FISCAL IMPACT

Departmental Costs

This bill is not expected to impact the department's costs.

Tax Revenue Estimate

This bill is estimated to impact PIT revenue as shown in the following table.

| Fiscal Year Cash Flow Taxable Years Beginning On or After January 1, 1999 Enactment Assumed After June 30, 1999 \$ Millions | | |
|---|---------|---------|
| 1999-0 | 2000-01 | 2001-02 |
| (\$2) | (\$4) | (\$4) |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact for this bill will be determined by the number of qualified adoptions made during any given taxable year, average qualifying costs, and the tax liabilities of claimants.

This estimate was developed in the following steps. First, the total number of adoptions by California residents was based on information received from the Department of Social Services. During fiscal year 1994-5, there were approximately 6,088 adoptions in California, of which 3,093 were public agency, 499 private, 1,850 independent, and 646 intercountry. Second, the total number of adoptions was increased 5% per year to allow for growth and an incentive effect from both federal and state tax incentives. Third, it was assumed that for this credit, independent, private, and intercountry adoptions would qualify. The typical cost for these adoptions is \$15,000 to \$18,000 per child. The maximum credit under this bill would be \$2,500 per child adopted. It was assumed that the average credit for taxpayers with AGIs less than \$75,000 would be \$2,500 and for taxpayers with AGIs between \$75,000 and \$115,000 would be \$1,250 due to the AGI phase out. The average out-of-pocket cost for public agency adoptions is only \$500. Fourth, based on AGI distributions for the general population of filers, it was assumed that approximately 80% of the above, non-public adoptions would qualify for this credit (2,800 adoptions for 1999-0). Of these, 80% of the adoptive parents are assumed to have AGI less than \$75,000. It was assumed on average that taxpayers with AGIs under \$75,000 would be able to use 50% of the credit, and taxpayers with AGIs between \$75,000 and \$115,000, 95% of the credit amount per year. It also was assumed that unapplied carryover credits would be exhausted in the subsequent year. Finally, revenue

estimates were adjusted to account for the repeal of current law credits of \$2 million based on updated departmental statistics.

BOARD POSITION

Neutral.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, as introduced February 24, 1999.

Don't delete this page, it was an amendment page. If you delete it will mess up the front page. Thanks!